



Interview: Dr. Marc Faber on the Federal Reserve and Hyperinflation

By Ron Hera

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The Hera Research Newsletter (HRN) is delighted to present the following powerful interview with noted speaker and best selling author Dr. Marc Faber, whose newsletter, [The Gloom Boom & Doom Report](#), highlights unusual investment opportunities. Dr. Faber is a popular speaker at investment seminars and conferences around the world and is best known for his contrarian investment approach.

Born in Zurich, Switzerland, Dr. Faber went to school in Geneva and Zurich and finished high school with the Matura. He studied Economics at the University of Zurich and, at the age of 24, obtained a PhD in Economics magna cum laude.

Between 1970 and 1978, Dr. Faber worked for White Weld & Company Limited in New York, Zurich and Hong Kong and, since 1973, has lived in Hong Kong. From 1978 to February 1990, he was the Managing Director of Drexel Burnham Lambert (HK) Ltd.

Dr. Faber's best selling book [Tomorrow's Gold – Asia's Age of Discovery](#) has been translated into Japanese, Chinese, Korean, Thai and German. Dr. Faber is a regular contributor to several leading financial publications around the world.

Dr. Faber, who is an investment adviser and fund manager associated with a variety of funds, is a member of the Board of Directors of numerous companies around the world.

Hera Research Newsletter (HRN): Thank you for joining us today. You've commented that the Federal Reserve's policies have been linked to past boom and bust cycles in the US economy. Why do you believe that?

Dr. Marc Faber: Booms and busts happen also under the gold standard like we had in the 19th century various railroad and canal booms, and we also had real estate booms, first on the east coast in Chicago, then, at end of the century, in California. What the Federal Reserve has really done is create a lot of economic volatility. If you look back at the various crisis starting with the [S&L crisis](#) in 1990, then the Tequila crisis [the [Mexican Peso crisis](#)] in 1994, then [Long Term Capital Management](#) (LTCM), the NASDAQ bubble and at the current crisis, each crisis actually became worse and worse and the bubbles became bigger and bigger. The Federal Reserve did not pay any attention to excessive credit growth. The reason I am so negative about the Federal

Reserve's policies is that they only target core inflation and argue that they can't identify bubbles, but when each bubble bursts they flood the system with liquidity that bring about unintended consequences.

HRN: What would be an example of that?

Dr. Marc Faber: Commodity prices peaked in May 2006 and after May 2006, especially in 2007, where there was actually a slowdown in the global economy and so there was no reason for commodity prices to go ballistic, but the Federal Reserve slashed interest rates after September 2007. In a global economy that was going into recession, the price of oil went from \$78 to \$147 and that burdened the US consumer with additional "tax" of five hundred billion dollars. I am not saying that is the only reason but it helped push the US consumer into recession. The fact is that without the Federal Reserve's expansionary monetary policy after 2001, we wouldn't have had a housing bubble to the same extent. The Federal Reserve's policies basically encouraged sub prime lending; it's not the case that they discouraged it.

HRN: Is there a relationship between monetary expansion and the fact that the US economy depends so heavily on consumption?

Dr. Marc Faber: Basically, if you look at consumption as a percent of the economy and at housing activity, the excessive debt growth began essentially after LTCM and, I have to say, it was a huge mistake of the Treasury and Fed to bailout LTCM because it gave Market participants in the financial sector a signal that there is a Greenspan put, and later on a Bernanke put, with an even higher strike price and this resulted in excess leverage. So, if you have problems, the Federal Reserve will bail you out or the system will bail you out. That's where I think the Federal Reserve acted irresponsibly—irresponsibly—that has to be said very clearly. They didn't pay attention to credit growth. Every central banker in the world pays attention to credit growth, but not in the US.

HRN: What would you recommend that the Federal Reserve do differently?

Dr. Marc Faber: The first action Mr. Bernanke should take is to resign. If I had messed up the system so badly, as he has done, I would have to resign. He has talked constantly about the Great Depression and what caused the depression but the problem is that he really doesn't understand what caused the depression, which was also excessive leverage at that time. I have to stress that in 1929 the debt to GDP ratio was of course minuscule in comparison what it is today. It was 186% of GDP but you didn't have Social security, Medicare and Medicaid and unfunded liabilities for Social Security and so forth. So, debt today, as a percent of GDP, is 379% and if you add the unfunded liabilities we are at over 800%. The Federal Reserve should pay attention to that.

HRN: With debt levels and liabilities so high, what solution is there for the United States?

Dr. Marc Faber: The solution is, basically, for the government to move out and not intervene in the economy. There are economists who will dispute that the Federal Reserve is partially responsible for the crisis and there are economists that will still tell you that debt doesn't matter, that deficits don't matter and they want to continue to intervene in the free market constantly. To these economists I respond: What about Fanny Mae and Freddy Mac? It was an intervention by the government into the housing market and into the mortgage market and the biggest bankruptcies—bigger than Citigroup and all the banks—are Fanny Mae and Freddy Mac—government-sponsored enterprises. The same economists will tell you that the government has to

intervene and to these economists I say: Well, you have made so many mistakes already with interventions do you think that in the future your interventions will improve anything? Einstein defined insanity as doing the same thing over and over and expecting different results, but these economists and the Federal Reserve think that by more interventions with fiscal measures and more money printing they will improve things. No, they won't. They will make things worse.

HRN: It seems the US is moving towards more government intervention into the free market rather than less.

Dr. Marc Faber: Yes. That's why I'm very negative about economic growth in the US. It just won't happen. Can the US economy grow at 2% per annum or, in the best case scenario, at 3% per annum with current policies? Yes, but it will create a lot of distortions. The best case for an economy that goes into a boom phase, in other words over consumption, is to bring it back into the trend line as quickly as possible. So when you have an excursion into a boom, what you need is a cleansing of the system and that may take a few years to happen in the US because the excesses were built up not just in the last 7 years between 2000 and 2007 but, over the last 25 years. So, to really bring the US back into sanity—into a healthy mode where the economy can grow—might take 5 to 10 years, but it won't happen under the Obama administration.

HRN: Given the poor prospects for US economic growth, do you foresee a flight of capital from the United States?

Dr. Marc Faber: You would be out of your mind, with health care reforms and with the government interventions and the uncertainty about future taxes in the US, to even consider expanding in the US and this is a problem. I mean people say that loan demand is down because banks are not lending, but maybe nobody wants to borrow any money in the US and nobody wants to expand in the US but they are expanding in China, India, Vietnam, Bangladesh, Africa and Brazil. The business world is an international place today, and if you run a corporation, whether you employ 50 people or 10,000, you can choose where you invest your money in terms of capital spending. Where do you want to expand factories? If I employed people in the US, I would rather think of reducing the 50 employees maybe to only 20.

HRN: Where should American investors put their money?

Dr. Marc Faber: Different people have different investment objectives but I made a presentation recently where I showed, that in terms of goods markets, the emerging world is now larger than the developed world and so I think people should have at least 50% of their money in emerging economies. With interest rates at zero and with the prospect that they will stay at zero, or below zero in real terms for a long time, I think cash is not particularly attractive. I think US government bonds are unattractive in the long run, although they may be attractive for the next three months. I would recommend to people to accumulate precious metals and invest in a basket of shares in emerging economies.

HRN: Are you saying you would consider buying gold even at today's prices?

Dr. Marc Faber: Yes, I keep accumulating gold although in the next three months it may go down and not up, but maybe it won't go down. To me, it doesn't really matter if it goes down by 10% or 20% or whether it stays where it is. I think if in case gold came down 20% it would be because tightening of global liquidity and, in that scenario, equities wouldn't do particularly well either.

HRN: You mentioned that cash is not attractive. What are the prospects for the US dollar?

Dr. Marc Faber: The dollar has been relatively weak in the last few years. It's just that the other currencies are not much better. There has been a tendency for the dollar to weaken and certainly it has weakened against the price of oil, against the price of precious metals and raw materials and it's lost its purchasing power. There is no question about the fact that, today, if you have \$100,000 you can buy less than 10 years ago or 20 years ago. Just look at the housing market. It has come down somewhat but a house is much more expensive than in 1980.

HRN: Can you comment on inflation versus deflation?

Dr. Marc Faber: In this whole inflation and deflation debate investors have to realize that in a system—say you have a room like this and then the money is dropped from helicopters into this room, it can flow into real estate; it can flow into equities; it can flow into precious metals; it can flow into the art market or it can flow out into other currencies or into commodities that the Federal Reserve doesn't control. They only control essentially how much money they will drop from the helicopters.

HRN: Is this an example of why central planning of the economy by the Federal Reserve isn't effective?

Dr. Marc Faber: Yes. Exactly.

HRN: Do you think hyperinflation in the US is possible?

Dr. Marc Faber: The Federal Reserve doesn't want to create a hyperinflation. I mean Mr. Bernanke may be incompetent, but he's not an evil person *per se*. He just doesn't have sufficient knowledge to be a central banker, in my opinion, and has misguided economic theories, but he's not evil in the sense that he would not wish to debase the currency entirely. Clearly, if the US economy moves into a double dip recession and you have deflationary pressures reappearing, in the housing market, for example, and if the S&P drops from roughly 1,100 down to say 900, then I think further monetization will happen. I believe that because of the unfunded liabilities and the deficits of the US government, which will stay high for a long time; sooner or later there will be more monetization anyway.

It's more a question of when it will happen rather than if it will happen. For sure it will happen but will it happen right away, say in September, or maybe only in two years time? Eventually, before everything collapses we'll have an inflationary bout which may not be so strongly felt in consumer prices, as in stocks or housing or precious metals prices or in commodities like oil; or inflation could occur mostly in foreign currencies, in other words, in Asia where the currencies could appreciate.

HRN: Thank you for being so generous with your time.

Dr. Marc Faber: Thank you.

After Words



Dr. Marc Faber is not only one of the world's most outspoken critics of the Federal Reserve and of its monetary policy, but is quite possibly the Federal Reserve's most credible critic. Dr. Faber's detailed, evidence-based arguments, linking Federal Reserve policy decisions, such as interest rate changes, to economic developments like the US housing bubble and oil price changes are supported by thorough research. Dr. Faber's research raises serious questions about the results of central economic planning in the form of central bank monetary policy and about the wisdom of intervention into the economy by governments. The evidence suggests that centralized manipulation of money and credit has a destabilizing influence on the economy overall—it increases economic volatility—and has unintended consequences totally outside the control of so-called monetary authorities. History shows that well-intentioned lawmakers and their economic advisers cannot predict the outcomes and unintended consequences of economic interventions. Neither central bankers nor governments have been successful in substituting centrally planned economic agendas for the decentralized decisions of millions of entrepreneurs and owners of private capital, but they persist nonetheless with ever more centralized control and ever larger interventions. Dr. Faber confidently predicts that greater government control over the economy will hamper economic growth rather than stimulate it, and that interventions into the free market, no matter how large or well meaning, will continue to fail as they consistently have in the past.

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